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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

TEXAS EXTRUSION CORPORATION, PICKENS INDUSTRIES, INC., RICHARD W. PICKENS and LOUISE R. PICKENS,
Petitioners,

v.

LOCKHEED CORPORATION,
Respondent.

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Does a disclosure statement which fails to provide a complete and accurate description and evaluation of lawsuits which are the debtors' largest assets and defenses to the debtors' largest claims, and fails to state directly the primary choice presented to the creditors, satisfy the "adequate information" standard of 11 U.S.C. § 1125?

2. Does a bankruptcy court have the statutory and constitutional power to enter a final, dispositive order of dismissal, and make fact findings, concerning lawsuits involving breach of contract and fraud claims, as part of "proceedings in respect of confirmation of plans"?

3. Do Bankruptcy Rule 9003, DR 7-110(B) of the Code of Professional Responsibility, and Canon 3A(4) of the Code of Judicial Conduct, prohibit repeated and extended ex parte discussions between the bankruptcy judge and counsel for the winning party in a contested matter, where counsel and the judge prepare and discuss four amended versions of written findings of fact and conclusions of law?

LIST OF PARTIES

The parties to the proceedings below were:

Petitioners

Texas Extrusion Corporation

Pickens Industries, Inc. (holder of 100% of stock of Texas Extrusion Corporation)

Richard W. Pickens and Louise R. Pickens, husband and wife (owners of 80% of stock of Pickens Industries, Inc.)

Affiliates

Texas B&P Machine Co., Inc.

Texas Extrusion Presses, Inc.

Respondent

Lockheed Corporation

Affiliate

Lockheed Finance Corp.

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The petitioners, Texas Extrusion Corporation, Pickens Industries, Inc., Richard W. Pickens and Louise R. Pickens, hereby file this reply brief to the brief in opposition of Lockheed Corporation, and respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on May 12, 1988.

I.

Petitioners Have Not Waived Any Objections To The Adequacy Of The Disclosure Statement.

Respondent Lockheed Corporation ("Lockheed") totally misstates the record when it asserts petitioners failed to preserve for appeal the first two deficiencies in the disclosure statement discussed in their petition. Brief in Opposition of Lockheed Corporation ("Lockheed Response") at 7. In fact, on February 28, 1984, petitioners filed their motion and a brief in support of motion to reject plan of reorganization, in which they specifically objected to the failure of the disclosure statement to pinpoint the Lockheed litigation as being the pivotal question to be decided by the creditors, as well as the failure of the disclosure statement to fully describe the litigation. It also specifically stated to the Bankruptcy Court that admissions had been made by the plan proponents that valuation of the Lockheed lawsuit was the major question to be decided by the court, and that the essence of the plan was a settlement of the Lockheed litigation. The brief then stated:

> That the proponents of the plan have made these admissions to the Court is simply astounding and remarkable—*FOR THE PROPONENTS TO ADMIT*

> *THAT THESE ARE THE KEY CONSIDERATIONS FOR APPROVAL OF THE PLAN CONSTITUTES AN ADMISSION BY THEM THAT THE DISCLOSURE STATEMENT IS TOTALLY INADEQUATE, SINCE NONE OF THESE STATEMENTS, NONE OF THIS ANALYSIS, AND NO BASIS FOR VALUATION OF THE LOCKHEED SUIT, ARE CONTAINED IN THE DISCLOSURE STATEMENT!*

Brief in Support of Motion to Reject Plan of Reorganization at 10-11 (Emphasis in original). The motion was argued at the Confirmation Hearing. Conf. Hear. at 268-270. Respondent's claim of waiver is frivolous.

Contrary to respondent's assertion that the Fifth Circuit made a finding of waiver regarding the argument equitable subordination, (Lockheed Response at 7, n. 4), the court made no such finding. Rather, the Fifth Circuit's comment about the absence of a pending action seeking equitable subordination was intended to bolster the court's opinion that it was "mere conjecture" to discuss equitable subordination in the disclosure statement. App. at 28a. However, the Fifth Circuit did *not* state that petitioners had waived their equitable subordination argument, by failing to preserve error or otherwise. Indeed, petitioners argued throughout the confirmation hearing that Lockheed's claim should not be given full value, but that equitable subordination should be applied. *See, e.g.*, Conf. Hear. at 205-206.

Finally, respondent's assertion that the failure of the disclosure statement to give adequate information about the Lockheed litigation or the true purpose of the plan was never presented to the Fifth Circuit, Lockheed Response at 7, n. 4, is a distortion of the record. In the

statement of issues presented for appeal to the Fifth Circuit, issue number two was:

> 2. Did the disclosure statement provide "adequate information" as required by 11 U.S.C. § 1125(d) sufficient to allow the creditors to make a reasonably informed decision concerning the dismissal of the Lockheed litigation and the valuation of the debtors' estates?

Petitioners' 1987 Fifth Circuit Brief at 1. The first section of the argument in such brief was entitled "The disclosure statement utterly failed to give adequate information about the Lockheed litigation or the true purpose of the plan." At page 22 of such brief, petitioners presented to the Fifth Circuit the *identical* all-capitals paragraph found at page 9 of their petition for certiorari to this Court, and supporting argument virtually identical to that presented here. Lockheed's misrepresentations to this Honorable Court are indefensible.

II.

Petitioners Have Not Waived Their Objections To The Constitutional Authority Of The Bankruptcy Court To Adjudicate Petitioners' State Law Claims.

In reliance upon *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833 (1986), respondent asserts that petitioners waived their argument that the bankruptcy court lacked constitutional power to adjudicate their claims. Lockheed Response at 11, n. 9. In *Schor*, the party complaining of the lack of an opportunity to proceed before an Article 3 court had expressly demanded that the opposing party proceed on its counterclaim in arbitration, rather than in district court, and never raised

any challenge to the forum until an unfavorable decision had been rendered. 106 S. Ct. at 3257.

The procedural history of this case was completely different. Although the claims of Texas Extrusion Corporation against Lockheed were originally filed as an adversary proceeding in bankruptcy court, the case was soon removed to the district court, on the motion of counsel for Texas Extrusion. Thereafter, the petitioners' individual claims against Lockheed were filed in district court. It was respondent Lockheed which moved to refer the corporate lawsuit and the individual suit back to the bankruptcy court, and petitioners opposed both motions. Petitioners moved to withdraw the reference of the corporate suit to bankruptcy court, and filed a "Notice of Nonconsent" *before* the conclusion of the confirmation hearing, stating that they did not consent to final, dispositive rulings by the bankruptcy court. Once again, respondent's argument of waiver is frivolous.

III.

The Disclosure Statement Did Not Contain "Adequate Information" Satisfying The Objective Standard Of The Statute.

The authorities relied upon by respondent do *not* support its assertion that application of the "adequate information" standard is a *subjective* determination. See Lockheed Response at 7-8. Instead, they simply observed, consistent with the statute, that determination of what is "adequate information" will vary from case to case. No authority cited by Lockheed, or of which petitioners are aware, other than the Fifth Circuit decision in this case, describes this as a "subjective" standard.

Rather, the statute defines "adequate information" as that which is sufficient to enable "a hypothetical reasonable investor" who is typical of his class to make "an informed judgment". This language, plus the fact that the Congress, in adopting this standard, was relying upon the same underlying premise as that found in the securities laws, establishes that Congress was intending to create an *objective* standard. *See* U.S. Code Congressional and Administrative News, 95th Congress, Second Session, 1978 at 6185-6186, 6187-6188.

The Lockheed argument that petitioners are to blame for the inadequacy of the valuation contained in the disclosure statement, see Lockheed Response at 9, is understandably not supported by citation to authority. Petitioners are aware of no area of law even outside the bankruptcy context, and certainly aware of no requirement anywhere within Section 1125, requiring the objecting party to cure the inadequacy of the document relied upon by his opponent.

The complaints by respondent that petitioners had failed to tender evidence supporting their objections to the disclosure statement seek to misplace the burden of proof. At no time in connection with the presentation of the disclosure statement did the proponents introduce any evidence supporting their contention that the disclosure statement contained "adequate information".

Of course, however, if evidence supporting petitioners' argument were required, petitioners have met their burden by demonstrating that the chairman of the creditors committee, one of the plan proponents, testified at the confirmation hearing that he did not know what the value of the lawsuit was, and that one could not determine the

value of the lawsuit by reading the disclosure statement. Conf. Hear. at 281-282.

IV.

The Bankruptcy Court Lacked Constitutional Authority To Make A Final, Binding Ruling Of Dismissal.

Respondent's answer to petitioners' constitutional claims, and claims of conflict with this Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982) is actually a house of cards built upon the faulty premise that petitioners are concerned about disposition of "private rights", and since "private rights" are always affected by bankruptcy rulings, there is no problem. *See* Lockheed Response at 11, 12, 13. Of course, this circular argument misstates the language, and the substance, of petitioners' argument. Petitioners are contending that by virtue of *Marathon*, the bankruptcy court here lacked constitutional authority to make a final, binding order disposing of their state law claims for fraud and breach of contract in the Lockheed litigation.

Here, the bankruptcy court did far more than merely applying federal law and then ordering a transfer of property, as respondent would have this Court believe. See Lockheed Response at 12. Instead, the bankruptcy court made detailed findings of fact purporting to find numerous facts relevant to the state law contract claims. App. at 75a-78a. Such findings were clearly the underpinning for the bankruptcy judge's ruling based upon federal bankruptcy law, and led to his dismissal of the corporate lawsuit, and his order resulting in the dismissal

of the individual lawsuit. In light of petitioners' notice of nonconsent, it was error of a constitutional dimension for the bankruptcy court to purport to make binding determinations relevant to petitioners' state law contract claims.

Essentially, what respondent has done in its brief is to argue implicitly for application of the expansive rule discussed at pages 18-20 of the petition herein, without addressing the underlying problems inherent in this method of construction. As stated in the petition for writ of certiorari, the lower courts are desparately in need of guidance from this Court as to whether the expansive or restrictive interpretation of the jurisdictional statute is proper under *Marathon* and the decision of the Fifth Circuit in this case supporting the expansive interpretation must be overturned.

V.

This Court Should Reaffirm The Express Language Of Bankruptcy Rule 9003 Prohibiting Ex Parte Communications.

The very tenor of respondent's argument concerning this point actually underscores the urgent necessity for this Court to exercise its supervisory power and reaffirm the clear language of Bankruptcy Rule 9003. The contention that counsel for Lockheed "served simply as a scrivener" and had no actual discussions with the bankruptcy judge is a calculated attempt to deceive the Court. The bankruptcy judge commented that "none of the attorneys had any discussion with me. They had them through my law clerk." Hearing on motion to amend findings of fact and conclusions of law at 43. One of

the counsel for respondent admitted that the judge discussed the changes with his law clerk, "and we had several conversations with the law clerk". *Id.* at 44. The judge explained that the procedure utilized was that the law clerk would make certain notes and talk with him about the changes, that he would tell her what he wanted done, and that the law clerk then went over the changes with counsel for respondent. *Id.* at 52. The admitted fact that the findings of fact went through four separate drafts with this type of communication whereby the judge and Lockheed's counsel communicated repeatedly through the law clerk certainly indicates that counsel for Lockheed was acting as more than a scrivener, but rather was applying its own creative input in an attempt to influence the final product without counsel for petitioners being advised of what was occurring.

Respondent has been unable to answer petitioners' contention that the Fifth Circuit decision in this case, if left to stand as valid precedent, would encourage wholesale ex parte communications between counsel and judges. The analysis of the Fifth Circuit, based upon the concept of whether or not the matter was still "pending" before the judge, App. at 44a, was not based upon the text of Rule 9003, which prohibits communications "concerning matters affecting a particular case or proceeding". The Fifth Circuit's addition of the "pending" concept invites application by aggressive advocates to other fact situations.

Of course, since the bankruptcy judge still retained plenary power to modify, or even overturn, his order confirming the plan, it is ludicrous to argue that the matter was no longer "pending" before him. It certainly

is untrue to state that the written fact findings were not "matters affecting a particular case or proceeding".

The "harm" which petitioners have suffered is that following a hotly contested hearing, counsel for respondent collaborated behind closed doors with the bankruptcy court to create written findings of fact and conclusions of law designed to make petitioners' appellate process even more difficult than it would have been otherwise.[1] This was done in express violation of Bankruptcy Rule 9003 and applicable provisions of the Code of Professional Responsibility and Code of Judicial Conduct. No further demonstration of "harm" should be required, if Bankruptcy Rule 9003 is to have any meaning.

CONCLUSION

For the reasons stated above, as well as the reasons contained in the petition for writ of certiorari, the petition for certiorari should be granted. Upon final consideration, the written findings of fact should be stricken, and the order of the Bankruptcy Court either reversed, with the matter remanded to the Bankruptcy Court for further action, or, in the alternative, remanded to the District

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1. Examples of the material differences between the verbal and written findings of fact include the following: A verbal finding that respondent breached its contract with petitioner Texas Extrusion Corporation, App. at 101a, when no such finding appears anywhere in the written findings; a written finding that the debtor-in-possession was "unwilling or unable to submit a plan of reorganization", App. at 57a, when such finding was unsupported by the record and was not part of the court's verbal findings; a description in the written findings purporting to describe certain alleged guaranties of Richard and Louise Pickens as valid obligations, App. at 59a, when there was no competent evidence in the record supporting such a finding, nor was there such a verbal finding.

Court for a de novo determination of the facts consistent with 28 U.S.C. § 157, and this Court's ruling in *Marathon,* and petitioners should be awarded their costs and general relief.

Respectfully submitted,

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